MOTION FILED
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(13)

No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO SUBMIT AMICUS BRIEF; BRIEF AMICUS CURIAE OF STEPHEN NULL

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12 pp

MOTION FOR LEAVE TO SUBMIT UNTIMELY 5-PAGE BRIEF AMICUS CURIAE

Stephen Null respectfully moves for leave to submit his 5-page brief amicus curiae in support of the respondents' position in this Court and in support of the affirmance of the judgment of the United States Court of Appeals holding unenforceable pre-dispute arbitration clauses under section 10(b) of the Securities Exchange Act of 1934 and under RICO.

THE PARTIES' POSITIONS ON THIS MOTION

The respondents have consented to the filing of this amicus brief. The petitioners have declined to consent to its filing.

REASONS FOR GRANTING THE MOTION; INTEREST OF AMICUS

Only 1 week ago the amicus Stephen Null received notice from the present petitioner Shearson of the amicus' interest in this appeal. For the past 5 years, the amicus has been suing Shearson for securities fraud under section 10(b) in the Southern District of New York.* The amicus' action proceeded for 5 years without mention of arbitration until Feb. 6, 1987 when Shearson, for the first time after 5 years, raised an arbitration defense to the amicus' claim, specifically invoking this appeal and this Court's prospective decision. At *no time* prior to Feb. 6, 1987 did Shearson mention, suggest or hint to the amicus that Shearson would seek arbitration of the amicus' claim.

Clearly Shearson prepared its brief in this Court with an eye to all section 10(b) claims against it, including the amicus' claim. Yet the amicus could not have known until Feb. 6, 1987 of his

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* The amicus' action is entitled *Stephen Null v. Lehman Brothers Kuhn Loeb, Inc.*, index no. 80 Civil 7308 (S.D.N.Y.). In 1982 the defendant Lehman Brothers was merged into the petitioner Shearson, so that for the past 5 years since 1982 the amicus has been litigating against the petitioner Shearson.

interest in this appeal. Shearson alone controlled the timing of its arbitration defense against the amicus (Feb. 6, 1987) and thus controlled the disclosure to the amicus of his interest in the present appeal.**

Moreover, the amicus brief is only 5 pages in length and addresses important policy considerations apparently not otherwise addressed in the principal briefs: First, the amicus brief addresses the pervasive and adhesive quality of arbitration clauses in broker-dealer account agreements and thus the danger that their enforcement (because they are industry-wide) would insulate the securities industry from judicial review in the handling of client accounts.

Secondly, the amicus brief addresses the benefits of judicial development and precedent under section 10(b), offering specific examples of judicial protections which would be lost or unannounced in quasi-secret, unreported arbitration decisions.

Thirdly, the amicus brief addresses the integral role which judicial development plays in securing the deterrence function of section 10(b). *Randall v. Loftsgaarden*, 106 S.Ct. 3143, 3154 (1986). The amicus brief points out that: (1) Public deterrence depends upon publicity and reported decisions, whereas arbitration proceedings and decisions are quasi-secret and unreported, and (2) deterrence focuses not only on the parties to a dispute but also on the industry as a whole, whereas the arbitration forum in securities disputes is provided by the very same industry which is the target of the deterrence.

** In the amicus' action, the amicus has several contractual and waiver bases for opposing arbitration, in addition to the statutory basis now before this Court. In the amicus' action, the District Court has not yet ruled on the amicus' contractual, waiver and statutory defenses to arbitration. Thus the amicus has a direct interest in the statutory issues now before this Court, in addition to the amicus' separate contractual and waiver defenses to arbitration.

Significantly, the amicus' contractual defenses may be a vanishing breed. The amicus' arbitration clause was signed in 1979 with Shearson's predecessor Lehman Brothers. Shearson apparently now uses a more comprehensive arbitration clause which, for future signatories, appears to eliminate the contractual defenses available to the amicus. (See amicus brief at p. 1, n.1).

The amicus brief points out that a pervasive deferral to arbitration under industry-wide arbitration clauses not only would insulate the securities industry from judicial review in the handling of client accounts but also would reduce or remove the critical deterrence function of publicly reported decisions rendered in a non-industry forum.

The amicus brief is only 5 pages in length, addresses these critical public-policy considerations, and was delayed only because the petitioner Shearson delayed until Feb. 6, 1987 in informing the amicus Stephen Null that Shearson would invoke against the amicus the parties' arbitration clause following a decision in this appeal. The amicus brief should be accepted.

Dated: New York, New York
February 17, 1987

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TABLE OF CONTENTS OF BRIEF AMICUS CURIAE

	Page
TABLE OF AUTHORITIES	i
BRIEF AMICUS CURIAE	1
CONCLUSION	5

TABLE OF AUTHORITIES

CASES

Chasins v. Smith Barney & Co., 438 F.2d 1167 (2d Cir. 1970)	3
Clark v. John Lamula Investors, Inc., 583 F.2d 594 (2d Cir. 1978)	3
Randall v. Loftsgaarden, 106 S.Ct. 3143 (1986)	3, 4
Rolf v. Blythe, Eastman Dillon & Co., 570 F.2d 38 (2d Cir. 1978)	3
Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974)	3

STATUTES

Section 10(b) of Securities Exchange Act	passim
Sherman Act	4

RULES OF THE SECURITIES AND EXCHANGE COMMISSION

Rule 10b-10	3

BRIEF AMICUS CURIAE OF STEPHEN NULL

The amicus curiae Stephen Null hereby submits his brief in support of the respondents' position in this Court and in support of the affirmance of the judgment of the United States Court of Appeals for the Second Circuit holding unenforceable pre-dispute arbitration clauses under section 10(b) of the Securities Exchange Act of 1934 and under sections 1962 and 1964 of RICO.

There are numerous policy reasons why this Court should affirm the judgment of the Second Circuit.

The enforcement of pre-dispute arbitration clauses would insulate the securities industry from judicial review and guidance in the handling of client accounts. In brokerage agreements, pre-dispute arbitration clauses are pervasive. In 1987 it is virtually impossible to open a brokerage account without signing a broad arbitration clause. The arbitration clauses are adhesion clauses which are industry-wide.[1]

Because arbitration clauses are pervasive, their enforcement would leave no opportunity for judicial development and guidance of broker-dealer obligations in parallel with arbitration. Enforcement of pre-dispute arbitration clauses under section 10(b) would leave the *entire* matter in arbitration.

This contrasts with numerous other legal settings. In numerous legal settings outside the securities industry, judicial development of the law proceeds in tandem with arbitration: The Courts develop and define the law where the parties have not agreed to arbitration, while the arbitrators apply the judicial precedent where the parties agree to arbitrate. Under a given

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[1] The different experiences of both the amicus and the respondents with petitioner Shearson are instructive. In 1979 the amicus signed an arbitration clause (with Shearson's predecessor Lehman Brothers) which is *not* broad and which contains contractual limitations on arbitration. But now Shearson apparently uses a broader, tighter arbitration clause (See pp. A26 and A28 of Second Circuit Appendix). (Amicus has reserved his rights under his 1979 agreement; see attached motion at p. ii, n.**).

body of law, the judicial and arbitral forums proceed in parallel, with the ultimate responsibility placed on the Courts to develop the law for both judicial and arbitral application.

This parallel development would *not* occur in the broker-dealer context if pre-dispute arbitration clauses were enforced. The pervasive and adhesive nature of arbitration clauses in broker-dealer agreements would, if enforced, preclude judicial involvement parallel to the arbitration process and thereby would insulate the securities industry from judicial scrutiny and guidance in the handling of client accounts.[2]

Judicial development and definition have been mainstays of section 10(b). The tables of authorities to the briefs now before this Court are testaments to the judicial solicitude which has guided and defined section 10(b), ensuring that it remains a potent, yet manageable force in the regulation of the nation's securities industry, while simultaneously ensuring that its development remains subject to public and professional scrutiny and criticism. These benefits of publicly guided judicial development would be lost in a pervasive delegation of responsibility to arbitral jurisdiction.

These benefits are as essential in a broker-dealer setting under section 10(b) as in any other setting under section 10(b). Liquidity and confidence in the secondary securities market are essential

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[2] Arbitration clauses also are pervasive in labor-management disputes. However, the labor-management setting (unlike the securities industry) contains built-in checks against arbitral abuse. The underlying labor contract is renegotiated periodically, so that arbitral error (and even the agreement to arbitrate) may be the subject of periodic negotiation.

These built-in checks are *not* present in the securities industry. Aggrieved investors do *not* have the realistic opportunity to renegotiate the standards used in the arbitrations or to avoid the arbitration clauses altogether.

Thus the enforcement of pre-dispute arbitration clauses in the securities industry would insulate the industry from judicial standards and other safeguards which protect investors.

to liquidity and confidence in the primary market. The primary market which finances corporate growth and equity depends upon the secondary market for its own liquidity when primary-market investors seek to realize their gains or limit their losses. The judicial protection and regulation of this secondary market under section 10(b) are integral to the securities laws and to the protections upon which investors depend.

In a broker-dealer setting, the *federal judiciary* has announced and/or developed numerous investor-protections which would be lost or unknown under a pervasive deferral to arbitration. In a broker-dealer context, the *judiciary* has initiated and/or developed, without limitation, the following investor protections: (1) against undisclosed conflicts of interest by broker-dealers who operate as market makers, *Chasins v. Smith Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970),[3] (2) against the use of client-accounts to trade on inside information, *Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974), (3) against aiding and abetting the purchase of unsuitable securities, *Rolf v. Blythe, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978), and (4) ensuring the proper measure of damages to compensate for broker-dealer fraud. *Clark v. John Lamula Investors, Inc.*, 583 F.2d 594 (2d Cir. 1978).

The Congressional purpose in enacting section 10(b) inherently requires a judicial forum. Section 10(b) is designed not only to compensate defrauded investors but also to deter fraudulent misconduct in the nation's securities markets. *Randall v. Loftsgaarden*, 106 S.Ct. 3143, 3154 (1986). This deterrence function requires a judicial forum for 2 reasons: First, deterrence focuses not merely on the specific defendants but also on the industry as a whole. Because the securities industry itself is properly the focus of deterrence in private litigation, an arbitral forum provided by the same industry is unlikely to perform this deterrence function.

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[3] As a result of the Second Circuit's decision in *Chasins*, the SEC promulgated Rule 10b-10 requiring disclosure on confirmations of a broker-dealer's position as a market maker.

Secondly, viable deterrence requires *publicity*. Closed arbitral proceedings without public record, without reported findings or conclusions and without published opinions cannot perform the strong public-deterrence function which section 10(b) envisions.

The deterrence function of section 10(b) highlights the irony of the petitioners' present argument. The petitioners (and the securities-industry amicus) argue for enforcement of arbitration clauses because the industry perceives a more sympathetic forum in arbitration. Yet the same reasons for the industry's preference also *reduce* the deterrent effect of an arbitral forum for section 10(b) claims. Thus the true premise of the petitioners' argument itself compels the judicial forum which the petitioners seek to avoid.

Nor can the SEC and the U.S. Attorneys' Offices provide this broad deterrence under section 10(b). The resource and manpower limitations of public authorities limit their efforts to the more flagrant and outrageous cases of fraud. These limitations in the public sector have underscored reliance on private enforcement: "Private rights of action . . . provide a most effective weapon in the enforcement of the securities laws and are a necessary supplement to Commission action." *Randall v. Loftsgaarden*, 106 S.Ct. at 3154 (1986). No less than antitrust plaintiffs who protect the public interest under the Sherman Act, securities plaintiffs protect the public interest under section 10(b) by acting as private attorneys general in prosecuting their individual section 10(b) claims.

During the past 35 years, Congress has not disturbed the virtually consistent holdings of the Courts of Appeals declining to enforce against clients pre-dispute arbitration clauses under section 10(b).

CONCLUSION

The public authorities themselves cannot protect the strong public interests in judicial development of section 10(b) and in deterrence of its violations, thereby placing the responsibility on individual plaintiffs. Nor can individual plaintiffs secure these interests in an arbitral forum with its closed, unexplained and quasi-secret proceedings in an industry-sponsored setting. A broad deferral to arbitration also would insulate the securities industry from judicial review in the handling of client accounts because of the adhesive and industry-wide use of arbitration clauses. A private cause of action in federal court must remain, unencumbered by pre-dispute arbitration clauses.[4]

This Court should affirm the judgment of the United States Court of Appeals for the Second Circuit and should hold unenforceable pre-dispute arbitration clauses in litigation brought under section 10(b) of the Securities Exchange Act of 1934 and under sections 1962 and 1964 of RICO.

Dated: New York, New York
February 17, 1987

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[4] Many of the same arguments which compel adjudication of section 10(b) claims also compel a judicial forum for RICO claims. The interests of brevity in this belated amicus filing compel mention of RICO without repetition of the same arguments applicable to section 10(b).